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UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,
Plaintiff,

v.

CHARLES CATHCART, SCOTT
CATHCART, YURIJ DEBEVC, a/k/a
YURI DEBEVC, ROBERT NAGY,
DERIVUM CAPITAL (USA), INC.,
VERIDIA SOLUTIONS, OPTECH
LIMITED, CHIHSIU HSIN, a/k/a
CHARLES HSIN, FRANKLIN
THOMASON

Defendants.

Civil No. 07-4762-PJH

**DEFENDANTS CHARLES HSIN
AND OPTECH LIMITED'S
NOTICE OF MOTION; MOTION
TO DISMISS OR FOR A MORE
DEFINITE STATEMENT
PURSUANT TO FRCP 8(a), 8(e), 9(b)
AND 12(e); MEMORANDUM OF
POINTS AND AUTHORITIES IN
SUPPORT THEREOF**

Hearing Date: August 27, 2008

Time: 9 A.M.

Courtroom: 3

Judge: Hon. Phyllis J. Hamilton

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TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on August 27, 2008, at 9 a.m., or as soon thereafter as the matter can be heard in the above-entitled court, located at 450 Golden Gate Avenue, San Francisco, California 94102, Defendants Charles Hsin ("Hsin") and Optech Limited ("Optech") (collectively, "Defendants") will move this Court, pursuant to Federal Rules of Civil Procedure ("FRCP") 8(a), 8(e), 9(b) and 12(e), to dismiss the Complaint in this matter or, in the alternative, for a more definite statement.

This motion is based on this notice of motion and the following memorandum of points and authorities, and on all the papers, pleadings, and records on file in this action.

Specifically, as grounds for this motion, Defendants note the following:

1. In the first amended complaint (hereinafter "Complaint") in paragraphs 16, 17, 20, 35, 41, 48, and 49, Plaintiff The United States of America ("Plaintiff") makes bald conclusions without reference to specific facts. The conclusions included a conclusory statement that fraudulent acts or statements were made by the Defendants. The Plaintiff should be required to plead very specific facts that state who, what, when, where, and how the alleged fact or facts constituted fraud and other related conduct concerning any fraud conclusion.

2. The Plaintiff should also be required to plead facts that show how Defendants administered the loans as claimed therein. And then, explain why and how any administration of the loans by the Defendants is fraudulent or violate other provisions of the Internal Revenue Service ("IRS") Code.

3. In the Complaint, page 16 paragraph 87 does not state which paragraphs are being incorporated aside from paragraph 86. The Plaintiff should be required to plead which paragraphs are being incorporated.

4. In paragraphs 19, 43, and 91 of the Complaint, the Plaintiff asserts various conclusions based on "information and belief." The Plaintiff should be required to plead separately, exactly the facts it does or does not actually know.

1 5. In paragraph 16 of the Complaint, Plaintiff impermissibly lumps multiple
2 defendants together. The Plaintiff should be required to plead separately what actions
3 each defendant took that leads to the bald conclusion that the defendants work together
4 collectively, especially as to the moving Defendants, who were joined only recently in
5 this action.

6 6. In paragraph 17 of the Complaint, the Plaintiff impermissibly lumps
7 multiple defendants together. The Plaintiff should be required to plead separately stated
8 facts for each defendant, what specific transactions each defendant engaged in, when
9 each defendant engaged in transaction, and exactly what the harm was.

10 7. Similarly, in paragraph 20 of the Complaint, the Plaintiff improperly
11 lumps multiple defendants together. The Plaintiff should be required to plead separately
12 which company, person, or persons caused the change of an entity's identity.

13 8. Again, in paragraph 46 the Complaint impermissibly lumps multiple
14 defendants together. The Plaintiff should be required to plead separately when and
15 which defendant or defendants directed Optech to administer 90% loan products.

16 9. In paragraph 49, the Plaintiff also impermissibly lumps multiple
17 defendants together. The Plaintiff should be required to plead separately when and
18 which defendant or defendants initially marketed the 90% stock loan program.

19 10. In paragraph 53, Plaintiff improperly lumps multiple defendants together.
20 The Plaintiff should be required to allege separately which defendant or defendants
21 caused the brokerage firm to sell the stock or Floating Rates Notes ("FRN").

22 11. In paragraph 54, the Complaint improperly lumps multiple defendants
23 together. The Plaintiff should be required to plead separately which defendant or
24 defendants received 10% of the proceeds from the sale of stocks, where the money
25 went, and state the companies and principals behind the companies that are the
26 purported off-shore lenders.

12. In paragraphs 74-80, the Plaintiff improperly lumps multiple defendants together. The Plaintiff should be required to plead separately which false statements each defendant made and when, why, and how the alleged statements created damage.

13. In paragraphs 81-86 the Complaint impermissibly lumps multiple defendants together. The Plaintiff should be required to plead separately what exact harms to the government each defendant caused including a factual basis for each and every harm.

If Plaintiff is unable to in good faith plead the above referenced facts with the appropriate level of specificity, the Complaint should be dismissed.

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF THE MOTION

I. INDUCTION AND FACTUAL BACKGROUND

Plaintiff's Amended Complaint added the two moving parties as defendants.

In the Complaint, the Plaintiff makes sweeping conclusory assertions of wrongdoing based at times only on "information and belief," which indicates that the Plaintiff is not aware of actual facts supporting its claims. Instead, the Plaintiff is using this civil action as a discovery tool to find justification for filing this action in the first instance. This is improper.

In particular, the Complaint fails to comply with FRCP Rule 9(b) heightened pleading requirements as to the following paragraphs: 16, 17, 19, 35, 41, 43, 46, 48, 49, 53, 74-87, and 91. As demonstrated below, the Complaint should either be dismissed, or in the alternative, pursuant to FRCP 12(e), the Plaintiff should be ordered to provide a more definite statement of its claims against Defendants.

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II. ARGUMENT – The Complaint Does Not Satisfy The Heightened Pleadings Requirements of Rule 9(b) and the Requirements of Rule 12(e)

Plaintiff has failed to comply with Rule 9(b) in three respects: (a) failing to plead specific allegations of fraud; (2) improperly pleading “on information and belief”; and (3) lumping all defendants together in allegations.

Rule 9(b) states:

In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.

FRCP 9(b). Moreover, under Rule 12(e) “[i]f a pleading . . . is so vague or ambiguous that a party cannot reasonably be required to frame a responsive pleading . . . the court may strike the pleading[.]” FRCP 12(e).

In *Vess v. Ciba-Geigy Corp. USA*, the Ninth Circuit held that Rule 9(b) requires that, when averments of fraud are made, the circumstances constituting the alleged fraud be specific enough to give defendants notice of the particular misconduct so that they can defend against the charge and not just deny that they have done anything wrong. 317 F.3d 1097, 1100 (9th Cir. 2003); *see also Schreiber Distrib. Co. v. Serv-Well Furniture Co., Inc.*, 806 F.2d 1393, 1401 (9th Cir. 1986) (complaint must state the time, place, and specific content of the false representations as well as the identities of the parties to the misrepresentation); *see also Comwest Inc. v. Am. Operator Services, Inc.*, 765 F. Supp. 1467, 1472 (C.D. Cal. 1991) (where allegations have been made against multiple defendants, the complaint must apprise each individual defendant of the specific nature of their participation in the alleged fraud). Due to the wording of the Complaint, the only response Defendants can make at this time is to plead a lack of information or to deny the allegation. The allegations are serious, the United States, the most sophisticated party in this court should be held to the highest standard.¹

¹ Once the United States waives sovereign immunity, this Court is required to treat the United States just like any private litigant. This includes complying with the burden of proof and evidence rules that attend the prosecution of a like action for an individual. *See U.S. v. Stinson*, 197 U.S. 200, 205 (1905) and *Bank Line, Ltd. v. U.S.*, 163 F.2d 133,

1 The case law discussed below, especially the Ninth Circuit precedent, establishes
2 the deficiency of the Complaint.

3 **A. Plaintiff's Complaint Fails to Meet the Minimum Requirement of**
4 **Pleading Fraud.**

5 In *Vess*, the plaintiff brought a class action claiming that three defendants acted
6 illegally to increase sales of the prescription drug Ritalin, in violation of the California
7 Consumers Legal Remedies Act and California's unfair business practice laws. *Id.* at
8 1100. The appellate court reversed in part and affirmed in part the district court's
9 holding. *Id.* at 1111. In particular, the appellate court reversed the district court's
10 holding that all of the Plaintiff's allegations were based on fraud and therefore did not
11 meet the required specificity of Rule 9(b) because some of the Plaintiff's allegations
12 described non-fraudulent conduct. *Id.* at 1106. The court held that averments of fraud
13 must be accompanied by "the who, what, when, where, and how" of the misconduct
14 charged. *Id.* at 1106, *quoting Cooper v. Pickett*, 137 F.3d 616, 627 (9th Cir. 1997).

15 In *U.S. v. Hempfling* (hereinafter "*Hempfling I*"), the government argued that
16 Rule 9(b) does not apply to a claim alleging a violation of IRC §6700 for defendant's
17 conduct that included conducting seminars, selling commercial tax products, charging
18 membership fees, and posting advertisements on his website. 96 A.F.T.R.2d (RIA)
19 6578 (E.D. Cal. 2005). The court rejected the government's argument and applied the
20 holding from *Vess* requiring the Plaintiff to plead the who, what, when, where and why
21 of the allegedly fraudulent conduct. *See also Hargrove & Constanzo v. U.S.*, 98
22 A.F.T.R.2d (RIA) 7028 (E.D. Cal. 2006) (Applying Rule 9(b) to a counterclaim
23 pursuant to IRC §6700). The court granted the defendant's motion to dismiss the
24 government's §6700 claim for failure to comply with Rule 9(b) because the government
25 failed to show where the seminars took place and what commercial tax products were
26 sold. Plaintiff's complaint lacked a range of dates during which plaintiff held his
27 138 (2nd Cir. 1947). The United States has waived sovereign immunity over the
28 contents of this civil action by filing the complaint.

1 seminars, posted information on his website², and sold his products; the court stated,
 2 “Whether or not 9(b) applies, Defendant is entitled to know the time frame of the
 3 allegedly fraudulent conduct.” The district court also held that requiring allegations of
 4 the location of the seminars serves the Rule 9(b) purpose to protect Defendant against
 5 the potential pretext for discovery against unknown wrongs.

6 The plaintiff submitted an amended complaint that the District Court held was
 7 sufficient to fulfill the requirements of Rule 9(b). *U.S. v. Hempfling* (hereinafter
 8 *Hempfling II*), 431 F. Supp. 2d 1069, 1076 (E.D. Cal. 2006). The plaintiff’s amended
 9 complaint provided the month, year, and in some instances the date of when the
 10 defendant engaged in the promotion and sale of abusive tax shelters. *Id.* at 1076. The
 11 Plaintiff also provided the location of where the tax shelters were promoted and sold.
 12 *Id.* A general time span from 2003-2005 was used to describe when the defendant
 13 promoted and sold information regarding tax shelters through his website.³ *Id.* The
 14 amended complaint also listed a date when a customer printed out a copy of materials
 15 offered for sale on defendant’s website as well as the date when a customer purchased
 16 three tax products, including the name of each product purchased, from defendant’s
 17 website. *Id.* at 1077.

18 On page 8 paragraph 48, the Complaint makes the bald conclusion that “Optech
 19 continues to administer the tax-fraud scheme.” The only factual support in paragraph
 20 48 for this assertion is that Optech “maintains a margin account with numerous
 21 brokerage firms.” A financial institution maintaining a margin account with brokerage
 22 firms is not unreasonable or illegal; it is merely evidence of maintaining a margin
 23 account and not that a particular type of loan is being administered. The only other
 24 factual basis purportedly in support of the claim in paragraph 48 is that by 2006, Optech

25 ² The government provided specific examples of statements that the defendant made on
 26 his website that denied filing income tax returns or paying income tax to the federal
 27 government is mandatory. *Id.* at n.1.

28 ³ The defendant’s website continues to operate today and promotes a catalog vending
 anti-tax materials: <http://www.welcome.freeenterprisesociety.com>.

1 principles Hsin and Thompson were the only two at Optech with trading authorizations.
2 Again, having trading authorization is not illegal or unusual for people who work at a
3 financial institution. Furthermore, a trading authorization in 2006 is irrelevant to
4 whether loans are being promoted unlawfully and administered in 2008. The Complaint
5 does not allege how maintaining a margin account or having a trading authorization is
6 related to fraudulent activity, and lacks any other factual support for the claim stated in
7 paragraph 48. The Plaintiff's allegation is conclusory and therefore is insufficient to
8 fulfill the requirements of Rule 9(b).

9 Unlike the defendant in *Hempfling II*, Optech does not continue to operate a
10 website or conduct any business. Like in *Hempfling I*, the defendant does not have
11 notice as to where the alleged loans were administered or promoted. In paragraph 13,
12 the Complaint states "Optech does business throughout the United States at the internet
13 address located at www.hk-Optech.com." Unlike *Hempfling I*, the Plaintiff does not
14 allege any specific statement made on Optech's website regarding fraudulent activity.
15 The Complaint does not allege that the website was offering the 90% loan program;
16 therefore, pursuant to the holding in *Hempfling I*, the Plaintiff should be required to
17 state what products were being sold through the website. Also, like in *Hempfling I*, the
18 Plaintiff must provide a range of dates during which the fraudulent activity was
19 promoted on the website. The Complaint should specifically plead what wording and
20 when the wording was posted on the website that the Defendants marketed or
21 administered the 90% loan program.

22 The web address listed in paragraph 13 is for a non-functioning website;
23 therefore, the court should reject the allegation that the Defendants continue to do
24 business through a web address. The Defendants request that the Court take judicial
25 notice that the referenced website does not operate, as it is subject to easy verification.
26 Two business addresses are listed in paragraph 13, but neither address is referenced in
27 the Complaint as being a location where loans were administered or promoted. The
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1 Complaint does not specifically allege a connection between the addresses stated in
2 paragraph 13 to any current promotion or administration of loans.

3 Likewise, on page 8 paragraph 48, the Complaint alleges, “Beginning in 2002,
4 Optech gave trading authorization to the same individuals who previously received
5 trading authorization from FSC, DDA, Derivium, BVL, and WITCO.” This allegation
6 is vague as to “the same individuals” and does not put the Defendants on notice as to the
7 identity of the “individuals.” No other reference is made in the Complaint to
8 individuals with “trading authorization.” And again, giving trading authorizations is a
9 common practice for companies engaging in financial transactions. The Complaint does
10 not allege how giving a trade authorization constitutes fraudulent activity. The
11 allegation in paragraph 48 fails to state “who” was engaged in particular fraudulent
12 conduct and how the conduct was fraudulent; therefore, the allegations in paragraph 47
13 do not fulfill Rule 9(b).

14 On page 7 paragraph 41, the Complaint alleges, “Eventually, Optech became the
15 sole lender for the tax-fraud scheme.” Pursuant to the holding in *Hempfling I*, the
16 Defendants should be provided a range of dates for when they allegedly become the sole
17 lenders of the alleged loans. Furthermore, the generalized use of the conclusory phrase
18 “tax-fraud schemes” does not state with the requisite particularity what conduct the
19 Defendants’ alleged loans are linked to. The Complaint fails to allege when, how, and
20 where Optech became the sole lender. This inconsistency leaves the allegation of loans
21 open to the pretext of discovery against unknown wrongs. The referenced allegation is
22 too vague to put the Defendants on notice as to what is being alleged.

23 On page 6 paragraph 35, the Complaint alleges, “Hsin has been a member of
24 numerous boards of directors of companies that Charles Cathcart owns...” The
25 Complaint fails to allege when, how, who, and where Hsin was a member of the board
26 of directors for any company, and the business of the company, or how this involvement
27 somehow equates to unlawful conduct. At the very least, following the holding in
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1 *Hempfling I*, Plaintiff should be required to state when and where Hsin served as a
2 member of a board in order to protect the Defendants against the pretext for discovery
3 against unknown wrongs. Further, paragraph 35 does not state how serving on a board
4 for unidentified companies is related to fraud. Paragraph 35 is vague and does not put
5 the Defendants on notice with the level of particularity required by the Ninth Circuit for
6 pleading fraud.

7 Moreover, on page 4 paragraph 16, the Complaint alleges, “Defendants
8 collectively market and implement various schemes...” This allegation is vague and
9 does not state the who, when, where, or how that the Ninth Circuit requires for pleading
10 fraud. What the schemes are should be pled specifically as to each defendant; like in
11 *Hempfling I*, what is being promoted must be pled with particularity. As discussed
12 below, this allegation also impermissibly lumps together all of the defendants; thus, the
13 Defendants are not on notice as to what harms each defendant caused.

14 Similarly, on page 4 paragraph 17, the Complaint alleges, “Defendants
15 implemented the scheme for hundreds of customers nationwide, with total transactions
16 worth more than \$1 billion resulting in the failure to report and pay hundreds of millions
17 of dollars in federal income taxes.” This allegation does not state the who, when, and
18 where that is required by the Ninth Circuit for pleading fraud. The Defendants are not
19 on notice as to what transactions each defendant engaged in or what portion of the
20 transaction worth “more than \$1 billion” each defendant was connected to or when any
21 of the transactions occurred. The Defendants also are not on notice as to how “the
22 scheme” was implemented nationwide. The only reference in the Complaint to Optech
23 operating nationwide is the web address that, as discussed above, should be plead with
24 particularity. As discussed below, paragraph 17 also does not differentiate between the
25 time periods when the Defendants operated the purported scheme, and this allegation
26 also impermissibly lumps the defendants together.

1 On page 4 paragraph 20, the Complaint alleges, “Defendants have frequently
2 changed the identities of the entities through which they conduct their activities...” The
3 Defendants are not on notice as to which defendant changed the identity of an entity,
4 when the change occurred, what the entity is, where the change occurred, or how the
5 change occurred. Companies frequently change names. Paragraph 20 does not allege
6 how changing the name of a company is related to fraudulent activity. Paragraph 20
7 should plead the who, what, when, where, why, and how changing the name of a
8 company is fraudulent activity.

9 On page 8 paragraph 49 alleges that “Defendants marketed the 90% Stock Loan
10 initially to people who held appreciated stock.” This paragraph does not put the
11 Defendants on notice as to who promoted the loan program, how, where, or when the
12 loan program was initially promoted. The Complaint alleges that Optech did not begin
13 administering loans until 2002, but First Security Capital (“FSC”) began operating in
14 1997. Paragraph 49 does not put the Defendants on notice as to which defendant was
15 initially promoting the loan program. The paragraph should plead, which loan programs
16 were being promoted, when, how and by which defendants as required by the Ninth
17 Circuit.

18 The Plaintiff also does not plead facts that provide Defendants notice as to what
19 the Plaintiff means by “administration of loans.” Issuing loans through a financial
20 institution to various companies involves many different aspects, but the Defendants are
21 not on notice as to what conduct it is responsible for in relation to the vague term
22 “administration.” The Complaint does not allege how or what aspect of the
23 administration of loans constitutes fraudulent activity. The Complaint also does not
24 allege where the loans were administered. Instead, the Complaint merely states that
25 defendants administered loans; this statement does not provide notice of fraud and
26 should be pled with particularity as required by Rule 9(b).

On page 16 paragraph 87 the Complaint alleges, “The United States incorporates by reference the allegations contained in paragraphs through 86.” This allegation does not adequately put the Defendants on notice because the allegation does not state the first incorporated paragraph. The plaintiff should be required to specifically state which paragraphs are being incorporated.

B. Plaintiff Has Failed to Comply with Rule 9(b) in Respect to Allegations Based on Information and Belief.

In *Sanderson v. HCA-The Healthcare Co.*, the Plaintiff charged that the defendants, and its corporate predecessors had violated the False Claims Act. 447 F.3d 873, 874 (6th Cir. 2006), *cert. denied*, 127 S.Ct. 303 (2006). The circuit court affirmed the district court’s holding pertaining to Rule 9(b) because the Plaintiff was unable to identify a specific fraudulent claim submitted directly to the United States by the defendant. *Id.* at 878. The circuit court held that although courts have permitted allegations of fraud based upon “information and belief,” the complaint “must set forth a factual basis for such belief,” and the allowance of “this exception ‘must not be mistaken for license to base claims of fraud on speculation and conclusory allegations.’” *Id.* at 878, *quoting U.S. ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 125 F.3d 899, 903 (5th Cir. 1997); *see also County of Santa Clara v. Astra U.S., Inc.*, 428 F. Supp. 2d 1029, 1036 (N.D. Cal. 2006) (Allegations of fraud based on information and belief do not satisfy the particularity requirement unless accompanied by a statement of the specific facts on which the belief is founded); *see also Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989) (Allegations of fraud based on information and belief do not satisfy FRCP 9(b) requirements, and mere conclusory allegations of fraud are insufficient.).

The Complaint lacks a factual basis for the allegation on page 4 paragraph 19 that “on information and belief, defendants are currently marketing and implementing a 90% Loan product involving the use of foreign trust.” The Complaint is devoid of

1 examples or factual support that defendants are currently marketing and implementing a
2 “90% Loan Product.” The Plaintiff’s complaint fails to plead for whom loans were
3 administered or when loans were administered that warrants an injunction for currently
4 administering loans. Like the Plaintiff in *Sanderson*, the Plaintiff has failed to identify a
5 single specific claim that shows the Defendants engaged in or are currently engaging in
6 fraudulent conduct.

7 The Plaintiff makes the conclusory allegation that based on information and
8 belief the defendants are currently marketing a 90% loan product; therefore, because
9 Optech administered loans in 2006, it is currently administering loans. The Complaint’s
10 only reference to current activity is the conclusory allegation that the defendants are
11 currently marketing and implementing a 90% loan product. The Plaintiff’s reliance on
12 conclusory allegations and failure to cite any reference or example of fraudulent
13 conduct for the past two years fails to fulfill the specificity requirements of Rule 9(b)
14 because the defendant, Optech, is not on notice as to what type of loan, for whom, or
15 when it administered or promoted a loan.

16 On page 7 paragraph 43, the Complaint also alleges that “on information and
17 belief, Optech and Veridia entered into an arrangement in or around 2002...” This
18 allegation fails to fulfill the Ninth Circuit’s requirement that allegations based on
19 information and belief do not satisfy the particularity requirement unless accompanied
20 by a statement of the specific facts on which the belief is founded. The allegation in
21 paragraph 43 alleging that there was an agreement does not refer to any factual support
22 for the allegation.

23 The Complaint refers to Optech and Veridia in paragraphs 46 and 47, pages 7-8,
24 but neither paragraphs allege factual support for pleading on information and belief
25 there was an agreement between Optech and Veridia. Paragraph 46 states, “In 2006
26 Veridia ceased operations, and BVL and Optech began to administer the 90% Loan
27 products...” This allegation is merely evidence of a company ceasing to do business
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1 and alleges other companies began to administer loans, but this does not indicate that
2 there was an agreement between Optech and Veridia four years prior. Paragraph 47
3 alleges, “Optech has taken over most aspects of the promotion, organization, and
4 operation of the 90% Loan program from Derivium, Veridia, and BVL.” This is a
5 conclusory statement that lumps together business transactions with three companies
6 and does not provide factual support for the allegation stated in paragraph 43.

7 The only other two references in the Complaint to Veridia are paragraphs 12 and
8 45, pages 3 and 7. Neither paragraph is relevant to the allegation that an agreement was
9 entered between Veridia and Optech. The Complaint’s conclusory allegation that there
10 was an agreement between Veridia and Optech lacks a factual basis to fulfill the
11 requirements of Rule 9(b).

12 On page 16 paragraph 91, the Complaint alleges, “On information and belief
13 defendants promote other schemes and in connection therewith engage in other conduct
14 subject to I.R.C. §6700 penalty.” Though the Complaint provides an inaccurate
15 depiction of “90% loans,” there is no reference or factual support in the Complaint that
16 “other schemes” are being promoted or administered. The Defendants are not on notice
17 as to whether the other schemes involve fraud. Even if the description of the loan is
18 regarded by the Court as true, two types of loans with various business, is not a factual
19 basis for the allegation on information and belief that the Defendants currently market
20 “other schemes” without more factual support.

21 **C. Plaintiff’s Complaint Impermissibly Lumps Multiple Defendants**
22 **Together.**

23 In *Swartz v. KPMG*, the Plaintiff sued the defendants for damages related to a
24 failed tax shelter. 476 F.3d 756-57 (9th Cir. 2007). The circuit court affirmed the
25 district court’s holding in part and reversed in part. *Id.* at 767. In particular, the circuit
26 court reversed the district court’s denial of leave to amend the complaint to plead more
27 specific details concerning the Plaintiff’s allegations of fraudulent conduct. *Id.* at 764.
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1 The Plaintiff made broad allegations against two defendants without any stated factual
2 basis: “knew that [KPMG and B&W] were making . . . false statements to clients,
3 including Swartz, and thus were acting in concert with [KPMG and B&W]” and “were
4 acting as agents [of KPMG and B&W]” and were “active participants in the
5 conspiracy.” *Id.* The court held that Rule 9(b) does not allow a complaint to merely
6 lump multiple defendants together but requires Plaintiffs to differentiate their
7 allegations surrounding the alleged participation in fraud. *Id.*

8 The false statements alleged in connection with the 90% loan program are stated
9 on pages 13-15 paragraphs 74-79. The statements listed in paragraphs 74-79 are similar
10 to the improperly alleged statements in *Swartz*. In this case, every paragraph that asserts
11 a false statement lumps all of the defendants together and does not state with specificity
12 who made the statements, when the statements were made, or where the statements
13 were made. None of the statements in paragraphs 74-79 specifically name Optech,
14 much less Hsin; the only company specifically listed is Derivium. The Plaintiff has
15 failed to differentiate its allegations surrounding Defendants’ alleged participation in
16 fraud.

17 On pages 15-16 paragraphs 81-86 of the Complaint, Plaintiff alleges various
18 harms to the government. Paragraphs 81-86 again lump all of the defendants together
19 despite the defendants having different roles in administering and promoting loans
20 during different time periods. Based on the Complaint, Optech did not begin to operate
21 as an off-shore lender until 2002 (pg. 7 paragraph 41), but in 1997 Charles Cathcart
22 founded FSC (pg. 5 paragraph 22). Based on the Complaint, there is a gap of five years
23 during which the 90% loan program was administered and promoted that does not apply
24 to Optech; therefore, Optech is not responsible for any harm to the government related
25 to the 90% loan program from 1997-2002.

26 The Complaint improperly alleges harm to the government that Optech (and
27 Hsin) could not have possibly caused. Paragraphs 83, 85, and 86 allege that various
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1 numbers of customers caused harm to the government from under reported taxes, but
2 does not differentiate between defendants. The pleadings in paragraphs 83, 85, and 86
3 fail to plead with specificity what harm and the amount of harm each defendant could
4 possibly be responsible for. Instead, paragraphs 83, 85, and 86 make general allegations
5 resulting in bloated figures that based on the Complaint cannot possibly apply to all of
6 the defendants.

7 On page 16 paragraph 84 states the only example of harm to government (see
8 dollar figures alleged in paragraphs 83, 85, and 86) based on a customer is a person
9 whose federal income tax return was audited in 2001. The complaint in *Hempfling II*
10 identified a date and customer who purchased the tax denier products. Based on the
11 Complaint, Optech did not begin to administer loans until 2002; therefore, Optech could
12 not have participated in the only example of a customer who's under reported taxable
13 income harmed the government. Furthermore, a transaction seven years ago is not
14 dispositive that the Defendants or any defendant currently administers any loans.

15 Paragraph 81 on page 15 is conclusory and cannot stand alone as a factual
16 allegation; paragraph 81 does not cite how, when, or who helped the customers.
17 Paragraph 82 is speculative as to who, how, or when defendants' customers filed
18 inaccurate returns. None of the allegedly false statements or harm to government
19 alleged in paragraphs 74-80 refer to Optech or an address where Optech does business.
20 The Complaint does not plead where the loans were administered and promoted.

21 On page 4 paragraph 16, the Complaint alleges, "Defendants collectively market
22 and implement various schemes..." By grouping all of the defendants together, this
23 allegation does not put the Defendants on notice as to what harms each defendant may
24 have caused. Based on the Complaint, in 2005 Veridia and Derivium Capital, LLC filed
25 for bankruptcy and neither company has done any business since (page 4 paragraphs 10
26 and 12). In 2006 Veridia ceased operation (pg. 7 paragraph 46). The Complaint also
27 alleges that FSC "continued to be involved with 90% Stock Loans and other
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1 transactions,” yet the Complaint also alleges that in 2000 FSC changed its name to
2 Derivium Capital, LLC- the same company that no longer does any business. It is not
3 possible for all of the defendants captioned to “collectively market and implement
4 various schemes” because various companies have gone out of business or ceased to
5 operate. Paragraph 16 should be pled with more specificity to put the defendants on
6 notice as to which defendants collectively work together.

7 On page 4 paragraph 17 of the Complaint, Plaintiff alleges that “Defendants
8 implemented the scheme for hundreds of customers nationwide, with total transactions
9 worth more than \$1 billion, resulting in the failure to report and pay hundreds of
10 millions of dollars in federal income taxes.” The Defendants are not on notice as to
11 which transactions each defendant engaged in or what portion, if any, of the more than
12 \$1 billion that each defendant is connect with. As discussed above, there are years in
13 which transactions may have taken place that the defendants could not have possibly in
14 engaged in. Paragraph 17 should be pled with more specificity, requiring the Plaintiff to
15 state the separate transactions each defendant engaged in and what, if any, of the
16 transactions resulted in a failure to report income taxes for each separate defendant.

17 On page 4 paragraph 20, the Complaint alleges, “Defendants have frequently
18 changed the identities of the entities through which they conduct their activities...” By
19 lumping the defendants together, the defendants are not on notice as to which
20 defendants changed identities. It was not alleged in the Complaint that Defendants ever
21 changed names; therefore, the Defendants should not be grouped with companies that
22 may or may not have “changed the identity” of an entity. The Defendants are not on
23 notice as to what entity’s identity it changed. Paragraph 20 should specifically allege
24 which companies changed the identity of an entity and not merely lump all defendants
25 together.

26 On page 7 paragraph 46, the Complaint alleges “In 2006... Optech began to
27 administer the 90% Loan products, particularly the ESOP QRP Loan, at the direction of
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1 the defendants.” Because the paragraph lumps the defendants together, the Defendants
2 are not on notice as to which defendants began directing Optech. The Complaint
3 alleges that the only other company cited as a defendant, Derivium Capital, LLC, filed
4 for bankruptcy in 2005 and has not done business since (pg. 3 paragraph 10). Paragraph
5 46 is confusing and does put the Defendants on notice as to which defendant directed
6 Optech. Paragraph 46 should be pled with particularity, stating which defendant(s)
7 directed Optech to administer loans in 2006.

8 On page 8 paragraph 49 alleges, “Defendants marketed the 90% stock loan
9 initially to people who held appreciated stock.” This paragraph does not put the
10 Defendants on notice as to which defendants initially marketed the 90% Stock Loan
11 program. The Complaint states that Optech did not begin administering and (or)
12 promoting loans until 2002, but FSC began administering loans in 1997. Paragraph 49
13 is confusing because there is a gap of five years in which the loan programs were first
14 promoted and when Optech allegedly began administering and (or) promoting loans.
15 The paragraph should separately plead which defendants initially marketed the 90%
16 loan program.

17 On page 9, paragraph 53 alleges “Defendants, either directly or through BVL,
18 Optech, or WITCO then caused the brokerage firm to sell the stock or FRN.” By
19 combining all of the defendants, it does not put the Defendants on notice as to which
20 defendant directly or through BVL, Optech, or WITCO caused a brokerage firm to sell
21 stock or FRN. In regard to the two newly amended Defendants, the paragraph alleges
22 that Optech either directly or through Optech caused the brokerage firm to sell the stock
23 or FRN. Paragraph 53 is confusing and does put the Defendants on notice as to which
24 defendant’s conduct is being referenced or when the conduct occurred.

25 On page 9, paragraph 54 alleges, “The remaining 10% was then allocated among
26 the defendants and the purported offshore lenders.” The allegation does not distinguish
27 which defendants received 10% of the allocated funds. Furthermore, it is unknown
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1 what companies are the purported offshore lenders. Paragraph 54 does not put the
2 defendants on notice as to which defendants received 10% of the allocated funds or
3 which companies are the off-shore lenders.

4 **III. CONCLUSION:**

5 Based on the foregoing reasons, Defendants respectfully request pursuant to
6 Federal Rules of Civil Procedure ("FRCP") 8(a), 8(e), 9(b) and 12(e), that the Court
7 dismiss the Complaint in this matter or, in the alternative, issue an order requiring the
8 United States to file a second amended complaint in compliance with the specific fact
9 notice pleading of Rule 9(b) and other applicable rules.

10
11 Dated: July 15, 2008

Respectfully Submitted,

ORD & NORMAN

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14 By /s/ Edward O.C. Ord
15 Edward O.C. Ord, Esq.
16 Attorney for Defendants
17 Charles Hsin and Optech Limited
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CERTIFICATE OF SERVICE

I hereby certify that on July 15, 2008, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF System which will send notification of such filing to the following:

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I further certify that on July 15, 2008, service of the foregoing was made upon the following by depositing a copy in the United States mail, postage prepaid:

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/s/ Edward O. Ord
EDWARD O. ORD